

QUALIFIED TRUSTS

U.S. OFFICE OF GOVERNMENT
ETHICS

OVERVIEW

- Trust Program Initiatives
- Purpose of Qualified Trusts
- Creating the Qualified Trust
- Types and Characteristics of Qualified Trusts
- Proposed Improvements

TRUST PROGRAM INITIATIVES

- Developing internal office manual on qualified trusts
- Rewriting regulation in plain English
- Creating new model letters for permissible communications
- Preparing pamphlet (in plain English) on qualified trusts for use by Executive Branch employees

AUTHORITY

- Statute: 5 USC App. §102(f)
- Regulation:
 - 5 CFR §2634.401 – §2634.503
 - 5 CFR §2634.310(b)(1)

DEFINITIONS

- Qualified Trust – a trust created under 5 USC App. §102(f) and certified by OGE
 - Blind
 - Diversified
- Interested Parties
 - Reporting individual (Executive Branch employee)
 - Spouse
 - Minor or dependent children
 - Representatives of these individuals (by regulation)

PURPOSE OF QUALIFIED TRUSTS

- To assist Executive Branch employees in resolving conflicts of interest
- Other conflict resolution tools:
 - Divestiture of asset
 - Recusal
 - Waiver

HOW DOES A QUALIFIED TRUST RESOLVE CONFLICTS?

- Employee does not know what assets the trustee acquires for the trust
 - Employee/other interested parties may not direct trustee's investment decisions
 - Trustee may not inform employee/other interested parties of identity of new investments

CREATING A QUALIFIED TRUST

- Employee selects proposed trustee
- Proposed trustee sends
 - Relationship letter
 - Certificate of Independence
- OGE approves trustee, if it meets independence requirements

CREATION OF TRUST

- Employee submits draft of trust instrument (unsigned) and list of assets going into the trust to OGE
 - Model trust instruments
- If requirements are met, Director of OGE certifies trust
- Within 30 days of certification, employee sends to OGE a copy of executed trust instrument and list of assets transferred to trust

INDEPENDENT TRUSTEE

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- 5 USC App. §102(f)(3)(A)(i)
- Financial institution, attorney, CPA, broker, or investment advisor who:
 - Is independent of and not associated with any interested party and
 - Is not currently and has not been an employee of or affiliated with any interested party and
 - Is not a relative of any interested party

OGE POLICY

- 5 CFR §2634.406(a)(2) – eligibility limited to a financial institution, not more than 10% of which is owned or controlled by a single individual, which is
 - A bank (§12 USC 1841(c))
 - An investment advisor (§15 USC 80b-2(a)(11))

DISQUALIFYING RELATIONSHIPS

- Current service as the investment advisor for the employee
- Concurrent service at any time with a director, officer, or employee of the trust company on the board of a for-profit company
- Friendship

NON-DISQUALIFYING RELATIONSHIPS

- Membership in a religious congregation where a director, officer, or employee of the trust company is also a member
- Provision of impersonal banking services by an affiliate of the trust company
- Acquaintance

SCENARIO A

- An employee is interested in setting up a qualified trust. She understands that she must select an independent trustee. She wants to know if she can use her current broker, Bill Smith, as the independent trustee. Can she?

COMMUNICATIONS

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- General Rule – no direct or indirect communications between trustee and interested party
- Exceptions
- Any proposed communications must be in writing and sent to OGE for review before they are sent to the other party
- Certificate of Compliance – May 15 each year

PERMISSIBLE COMMUNICATIONS

- 5 USC App. §102(f)(3)(C)(vi)
- Request for distribution of cash
- Communication of general financial interest and needs of interested party
 - Maximize income
 - Seek long-term capital gain
 - Balance current income with growth
 - Preserve capital

PERMISSIBLE COMMUNICATIONS

- Notification of trustee of law or regulation subsequently applicable to employee which prohibits an interested party from holding an asset (notification would direct that asset not be held by the trust)
- Direction to trustee to sell all of an asset initially placed in the trust by interested party which, in the determination of employee, creates conflict of interest or appearance of conflict due to subsequent assumption of duties by employee

IMPERMISSIBLE COMMUNICATIONS

- Employee could not give following directions to trustee:
 - Maintain an allocation between common stocks and bonds of 60/40
 - Invest only in publicly traded securities
 - Invest only in the securities of U.S. companies
 - Keep at least 20% in liquid assets

SCENARIO B

- An employee has questions about setting up a qualified trust. He knows that he has to select an independent trustee. He is concerned about how much direction he can provide to the trustee at the beginning of the trust. He would like to instruct the trustee not to invest in any telecommunications stock. Can he provide this instruction to the trustee?

CHARACTERISTICS OF BOTH TRUSTS

- Employee must select an independent trustee
- Communications between employee and trustee are extremely limited
 - Employee cannot instruct trustee on what investments to buy and sell
 - Trustee cannot reveal what assets he acquires for the trust
 - Communications must be in writing and pre-cleared by OGE

CHARACTERISTICS OF QUALIFIED BLIND TRUST

INITIAL ASSETS

- Any type of asset may be placed in the trust (real estate, stock, mutual funds, limited partnerships, and cash)
- None of the initial assets can be prohibited by law or regulation
- Initial assets placed in the trust continue to pose potential conflicts until they have been sold or reduced to a value of less than \$1,000

HOW DO ASSETS BECOME BLIND?

- Initial assets are sold and new assets are purchased or trust income is used to purchase new assets
- The employee has no knowledge of the new trust holdings
- The employee cannot receive a report of the trust holdings

REQUIRED REPORTS

- Quarterly report of the aggregate market value of the assets
- Annual report of the aggregate amount of the trust's income

OTHER COMMUNICATIONS

- The net income or loss of the trust and any other information needed for personal tax return
- Notification of disposal of an original asset or that asset value is less than \$1,000

CHARACTERISTICS OF QUALIFIED DIVERSIFIED TRUST

INITIAL ASSETS

- Well diversified portfolio of readily marketable securities (real estate, hedge funds, private partnerships cannot go into a diversified trust)
 - No more than 5% in any one issuer
 - No more than 20% in any particular or limited industrial, economic or geographic sector
- The initial assets may not contain securities of issuers having substantial activities in the reporting individual's primary area of responsibility
- The initial assets and subsequent assets are deemed not to pose conflicts of interest

REQUIRED REPORTS

- Quarterly report of the aggregate market value of the assets
- Annual report of the aggregate amount actually distributed from the trust

TAXES

- The trustee or designee prepares the trust and personal income tax returns
- The interested party provides the trustee or designee with non-trust information needed to prepare the personal income taxes

SCENARIO C

- An employee is interested in setting up a qualified diversified trust. He has stocks, mutual funds, real estate, and cash that he wants to put into the trust. Can he create a diversified trust?

SCENARIO D

- An employee is interested in setting up a qualified diversified trust. He owns 15 stocks that he would like to place in the trust. Can he create a diversified trust?

PROPOSED IMPROVEMENTS

- Modifying definition of “widely diversified” for diversified trust
- Modifying format for the annual report for the diversified trust

MODEL DOCUMENTS

- www.usoge.gov/home.html
 - Select “Forms, Publications, & Other Ethics Documents”
 - Select “OGE & SF Forms”
 - Scroll down the page until you see “Model Trust Documents”

POINTS OF CONTACT

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Questions?